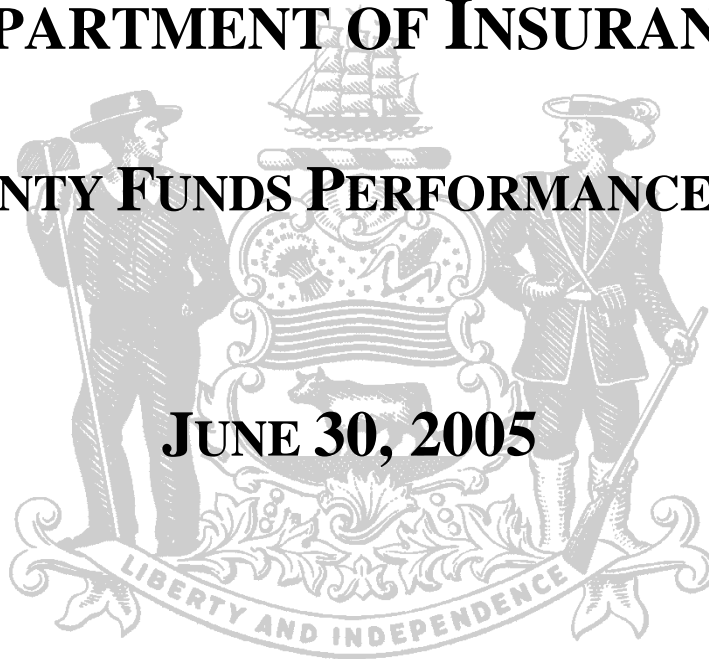


**STATE OF DELAWARE**  
**OFFICE OF**  
**AUDITOR OF ACCOUNTS**

**DEPARTMENT OF INSURANCE**

**GUARANTY FUNDS PERFORMANCE AUDIT**

**JUNE 30, 2005**



**R. THOMAS WAGNER, JR., CGFM, CFE**  
**AUDITOR OF ACCOUNTS**

---

# EXECUTIVE SUMMARY

---

## **BACKGROUND**

Under Title 29 Delaware Code (Del. C.), §2906(g), the Office of Auditor of Accounts (AOA) is directed to conduct post audits of all agencies, associations, and funds created directly or indirectly by the provisions of Title 18 or by the Insurance Commissioner.

Both the Delaware Insurance Guaranty Association (DIGA) and the Delaware Life and Health Insurance Guaranty Association (DLHIGA) were created by the provisions of Title 18, Chapters 42 and 44, respectively. It is the responsibility of both Associations to protect Delaware's resident policyholders when a member insurer is deemed to be insolvent. The Associations are also tasked with assessing fees to member insurers to pay for such protection.

Pursuant to 29 Del. C., §2906(g), AOA conducted a performance audit of the guaranty funds of the Delaware Department of Insurance (the Department), DIGA, and DLHIGA. The audit was performed in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States.

The specific objectives of the audit were:

- To determine if the Department's internal controls related to compliance with 18 Del. C., Chapters 42 and 44 are adequate to safeguard assets.
- To determine if the Department complied with 18 Del. C., Chapters 42 and 44.
- To determine if DIGA's internal controls related to compliance with 18 Del. C., Chapter 42 are adequate to safeguard assets.
- To determine if DIGA complied with 18 Del. C., Chapter 42.
- To determine if DLHIGA's internal controls related to compliance with 18 Del. C., Chapter 44 are adequate to safeguard assets.
- To determine if DLHIGA complied with 18 Del. C., Chapter 44.

## **AUDIT CONCLUSIONS AND OBSERVATIONS**

The Department, DIGA, and DLHIGA substantially met the aforementioned objectives. However, AOA noted the following opportunities to strengthen the internal controls of the Department, DIGA, and DLHIGA.

- Pursuant to 18 Del. C., §4208(a)(3)(b)(2), the Department did not submit the required annual financial report to DIGA by the October 31, 2004, deadline.
- Checks may be returned to the same person that initiated or authorized the payment resulting in a lack of segregation of duties.
- Proper documentation is not maintained when checks are returned to the Department for mailing resulting in a lack of supporting documentation.

---

# EXECUTIVE SUMMARY

---

- The Department's employees have access to the Insurance Commissioner's facsimile stamp and apply his signature as a second approval on financial documents without his actual review of the document resulting in a lack of authorization.
- DIGA and DLHIGA's monthly bank reconciliations prepared by the Controller are not signed and dated by the Controller or a reviewer to denote review and approval resulting in a lack of evidence to support timely completion and management review.

---

# TABLE OF CONTENTS

---

Audit Authority.....	1
Background.....	2
Objectives, Scope, and Methodology .....	3
Conclusions.....	5
Internal Control Strengths.....	6
Findings and Recommendations.....	8
Distribution of Report.....	11

---

# AUDIT AUTHORITY

---

Under Title 29 Del. C., §2906(g), the Office of Auditor of Accounts is directed to conduct post audits of all agencies, associations, and funds created directly or indirectly by the provisions of Title 18 or by the Insurance Commissioner.

The law requires that the audits be made in conformity with generally accepted auditing principles and practices. Such principles and practices are established by two standard setting bodies: the American Institute of Certified Public Accountants, which has issued Generally Accepted Auditing Standards; and the U.S. General Accounting Office, which has issued Generally Accepted Government Auditing Standards.

---

# BACKGROUND

---

## Insurance Department

Under the leadership of the Insurance Commissioner, Matt Denn, the Delaware Department of Insurance's (the Department) mission is to protect the public interest by regulating the insurance industry, enforcing the Unfair Trade Act as it relates to insurance, and assisting Delaware citizens and employers with their insurance needs and concerns. The Department's office is located in Dover, DE and consists of the following divisions:

- Bureau of Examination, Rehabilitation, and Guaranty
- Consumer Services & Investigations Division
- Producer Licensing & Continuing Education Division
- Fraud Prevention Bureau

## Delaware Life & Health Insurance Guaranty Association

The Delaware Life & Health Insurance Guaranty Association (DLHIGA) is a statutory entity created in 1982, when the Delaware legislature enacted the Delaware Life and Health Insurance Guaranty Association Act (refer to Title 18 Del. C., Chapter 44). DLHIGA is composed of all insurers licensed to sell life insurance, accident and health insurance, and annuities in the state of Delaware. In the event that a member insurer is found to be insolvent and is ordered to be liquidated by a court, the Guaranty Association Act enables DLHIGA to provide protection (up to the limits in the Act) to Delaware residents who are holders of life and health insurance policies and annuities with the insolvent insurer.

Specifically, when a member insurer is found to be insolvent and is ordered liquidated, a special deputy receiver takes over the insurer under court supervision and processes the assets and liabilities through liquidation. The task of servicing the insurance company's policies and providing coverage to Delaware's resident policyholders becomes the responsibility of DLHIGA. The protection provided by DLHIGA is based on Delaware law and the language of the insolvent company's policies at the time of insolvency.

## Delaware Insurance Guaranty Association

Title 18 Del. C., Chapter 42 establishes the Delaware Insurance Guaranty Association (DIGA). The Code provides a mechanism for the payment of covered claims under certain insurance policies to avoid excessive delay in payment and to avoid financial loss to claimants or policyholders because of the insolvency of an insurer, to assist in the detection and prevention of insurer solvencies, and to provide an association to assess the cost of such protection among insurers.

---

# OBJECTIVES, SCOPE, & METHODOLOGY

---

## **OBJECTIVES**

The performance audit encompassed a review of guaranty funds activity. This includes guaranty assessments received and payments made by the Department, DLHIGA, and DIGA.

The audit consisted of the following objectives:

- To determine if the Department's internal controls related to compliance with 18 Del. C., Chapters 42 and 44 are adequate to safeguard assets.
- To determine if the Department complied with 18 Del. C., Chapters 42 and 44.
- To determine if DIGA's internal controls related to compliance with 18 Del. C., Chapter 42 are adequate to safeguard assets.
- To determine if DIGA complied with 18 Del. C., Chapter 42.
- To determine if DLHIGA's internal controls related to compliance with 18 Del. C., Chapter 44 are adequate to safeguard assets.
- To determine if DLHIGA complied with 18 Del. C., Chapter 44.

## **SCOPE**

The Department reports activity on a fiscal year basis. As such, the Department audit covered the period of July 1, 2004, through June 30, 2005. DIGA and DLHIGA report activity on a calendar year basis. As such, the DIGA and DLHIGA audits covered the period of January 1, 2004, through June 30, 2005.

## **METHODOLOGY**

AOA conducted the audit in accordance with Generally Accepted Government Auditing Standards. Audit procedures consisted of interviews with the Department, DIGA, and DLHIGA personnel; review of policies and procedures at the Department, DIGA, and DLHIGA; reviewing documentation, such as audit reports, revenue and expenditure documents, correspondence, and meeting minutes; and tests of controls to confirm AOA's understanding and the effectiveness of the controls of the Department, DIGA, and DLHIGA.

The criteria used in the performance of this audit consisted of Title 18 Del. C., Chapter 42, *Delaware Insurance Guaranty Association Act*; Title 18 Del. C., Chapter 44, *Delaware Life and Health Insurance Guaranty Association Act*; Delaware Life & Health Insurance Guaranty Association "Plan of Operation"; Delaware Insurance Guaranty Association "Plan of Operation"; State of Delaware *Budget and Accounting Manual*; and *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organization of Treadway Commission (COSO).

---

# OBJECTIVES, SCOPE, & METHODOLOGY

---

In order to meet the aforementioned objectives, audit procedures were performed to determine:

## **The Department**

- The internal controls practiced by the Department.
- That the Insurance Commissioner approved new Board members.
- That the member insurers and Board of Directors were fairly represented.
- How the Class B Assessment was calculated.
- That DIGA and DLHIGA were notified by July 31, 2004, of the assessment amount.
- That the Department submitted an annual expenditures report to DIGA and DLHIGA by October 31, 2004.
- That the Insurance Commissioner obtained DIGA and DLHIGA's Plans of Operation and any amendments.
- That the Department notified DIGA and DLHIGA of any domestic insolvent insurers.
- That the Department notified DIGA and DLHIGA of any domestic impaired insurers.
- That the Department received and reviewed copies of DIGA's and DLHIGA's audited financial statements.

## **DIGA and DLHIGA**

- The internal controls practiced by DIGA and DLHIGA.
- That the DIGA and DLHIGA's Plans of Operation included the criteria required by Del. C.
- That the structure, terms, and selection of DIGA and DLHIGA's Boards of Directors were in accordance with Del. C.
- That the Insurance Commissioner approved new Board members.
- That the DLHIGA accounts were structured as required by Del. C.
- That DIGA and DLHIGA notified the Department of any domestic insolvent insurers.
- That DIGA and DLHIGA notified the Department of any domestic impaired insurers.
- If assessments were made to DIGA and DLHIGA member insurers and that these assessments, if any, were properly calculated.
- If any member insurer received a recoupment of assessment or credit for assessment paid.
- That only covered claims were paid by DIGA and DLHIGA and that these claims were within limits set by Del. C.
- That annual reports were prepared for DIGA and DLHIGA and submitted to the Department.
- That the balances of DIGA and DLHIGA's accounts at June 30, 2005, were complete and accurate.



---

# CONCLUSIONS

---

## **The Department**

The audit objectives regarding the Department were as follows:

- To determine if the Department's internal controls related to compliance with 18 Del. C., Chapters 42 and 44 are adequate to safeguard assets.
- To determine if the Department complied with 18 Del. C., Chapters 42 and 44.

The Department substantially met the audit objectives; however, the Department had the following findings regarding internal controls and the annual expenditures report.

- Pursuant to 18 Del. C., §4208(a)(3)(b)(2), the Department did not submit the required annual financial report to DIGA by the October 31, 2004, deadline.
- Checks may be returned to the same person that initiated or authorized the payment resulting in a lack of segregation of duties.
- Proper documentation is not maintained when checks are returned to the Department for mailing resulting in a lack of supporting documentation.
- The Department's employees have access to the Insurance Commissioner's facsimile stamp and apply his signature as a second approval on financial documents without his actual review of the document resulting in a lack of authorization.

## **DIGA and DLHIGA**

The audit objectives regarding DIGA and DLHIGA were as follows:

- To determine if DIGA's internal controls related to compliance with 18 Del. C., Chapter 42 are adequate to safeguard assets.
- To determine if DIGA complied with 18 Del. C., Chapter 42.
- To determine if DLHIGA's internal controls related to compliance with 18 Del. C., Chapter 44 are adequate to safeguard assets.
- To determine if DLHIGA complied with 18 Del. C., Chapter 44.

Both DIGA and DLHIGA substantially met the audit objectives; however, DIGA and DLHIGA had the following finding regarding internal controls:

- DIGA and DLHIGA's monthly bank reconciliations prepared by the Controller are not signed and dated by the Controller or a reviewer to denote review and approval resulting in a lack of evidence to support timely completion and management review.

---

# INTERNAL CONTROL STRENGTHS

---

The following internal control strengths were identified at the Department:

#	Strength	Process	Type of Control
1	Once wire transfers are received, the Accountant or the Administrative Officer prepares a paper cash receipt (CR) document for the wire transfers. The CR is manually signed and dated by the Controller.	Cash Receipt	Segregation of Duties; Management Review
2	Once invoices are received, the Accountant or the Administrative Officer prepares a paper payment voucher (PV), expenditure correction (EX), intergovernmental voucher (IV), or CR document and attaches supporting documentation. The document is then given to the Controller, who reviews and approves the PV, EX, IV, or CR document manually.	Cash Disbursement	Segregation of Duties; Management Review
3	If the invoices are for new or infrequent purchases, the Accountant or the Administrative Officer are given correspondence, generally through emails, that indicates approval to purchase by the Insurance Commissioner's Chief of Staff. If any purchase requires a purchase order, the Accountant or Administrative Officer receives an email from the Chief of Staff approving the purchase.	Cash Disbursement	Segregation of Duties; Management Review
4	The Accountant and the Administrative Officer complete reconciliations to the Delaware Financial Management System (DFMS) on a weekly basis; the DFMS suspense file is also reviewed weekly.	Cash Receipt; Cash Disbursement	Reconciliation
5	The Administrative Officer prints the payroll report and reviews to ensure all changes made during the pay period are correct. The Controller reviews the changes and all supporting documentation and approves the payroll.	Cash Disbursement	Reconciliation; Management Review

---

# INTERNAL CONTROL STRENGTHS

---

The following internal control strengths were identified at DIGA and DLHIGA:

#	Strength	Process	Type of Control
1	The Controller, who does not have signature authority, prepares checks. The Executive Director or the Claims Manager signs all DIGA checks. The Executive Director signs all DLHIGA checks.	Cash Disbursement	Segregation of Duties; Authorization; Management Review
2	All checks greater than \$5,000 require dual signatures.	Cash Disbursement	Authorization
3	No individual may sign a check payable to him or herself. Checks payable to the Executive Director are sent to the Chairman or other Officer for signature.	Cash Disbursement	Segregation of Duties; Authorization

---

# FINDINGS AND RECOMMENDATIONS

---

## **The Department**

### ***Finding 05-01:***

The Department is required to submit an annual financial report to the DIGA by October 31<sup>st</sup> of each year. The Department submitted the required financial report for 2004; however, it was after the October 31<sup>st</sup> deadline.

According to 18 Del. C., §4208(a)(3)(b)(2), the Department is required to submit a report to DIGA detailing the Department's expenditure of funds collected through Class B assessments. This report must be issued by October 31st of each year.

A lack of oversight by the Department resulted in noncompliance with 18 Del. C., §4208(a)(3)(b)(2).

***Type:*** Compliance

### ***Recommendation:***

The Insurance Department submit the annual expenditure report to DIGA by October 31st of each year.

### ***Auditee Response:***

The Department has established a procedure for the Controller to contact the Director of the Bureau of Examination, Rehabilitation, and Guaranty requesting information for the report. The report will be prepared, reviewed, and submitted prior to the October 31st deadline.

### ***Finding 05-02:***

Checks are returned to the Department for mailing if there are expenditures for the Workplace Safety Program and for registrations or other instances that require forms to be sent with the checks. The Department documents the check number, but does not maintain supporting documentation for these checks, such as copies of the checks or check logs. In addition, checks may be returned to the same person that initiated or authorized the payment.

The State of Delaware *Budget and Accounting Manual* states that agencies should “retain all financial documents until a successful audit has been completed.” In addition, the State of Delaware Division of Accounting Memorandum 03-03 states, “checks resulting from approved payments must not be returned to the person that initiated or authorized the payment.”

The risk of misappropriation of funds increases when vendor checks are not mailed directly to the vendors.

---

# FINDINGS AND RECOMMENDATIONS

---

**Type:** Control Weakness - Segregation of Duties

**Recommendation:**

The Department implement policies and procedures for transactions in which checks are returned to the Department for mailing/distribution to segregate duties according to the State of Delaware *Budget and Accounting Manual*. For example, checks returned to the Department can be returned to the mailroom clerk for documentation and mailing.

**Auditee Response:**

Checks will no longer be returned to the Department for mailing/distribution. The Department will provide more detailed information on the check address section and on the check stub to ensure accurate delivery of the check by the State Treasurer's Office.

**Finding 05-03:**

Department procedures require financial documents to have one live signature and one facsimile signature denoting approval.

Employees who have access to the Insurance Commissioner's facsimile stamp, apply his signature as a second approval on financial documents without his actual review of the documents. Allowing employees to have access to a facsimile stamp of the Insurance Commissioner's signature could lead to the misappropriation of assets.

The State of Delaware *Budget and Accounting Manual* defines authorization as a control objective that should be used by management and financial managers. Authorization is defined as "ensuring that all transactions are approved by management."

**Type:** Control Weakness - Authorization

**Recommendation:**

If a facsimile stamp is used as a second level of approval on financial documents, the person whose signature is on the stamp should apply the signature to the documents and no other individual should have access to the stamp.

If the Commissioner does not wish to approve documents, he should designate another authorized signer to apply the second level of approval. In addition, written policies and procedures should be revised to address proper authorization and approval.

**Auditee Response:**

A facsimile stamp will no longer be used as a second level of approval on financial documents. There will be two live signatures on all documents \$2,500 and above. Financial documents below \$2,500 will contain one live signature only. Policies and procedures will be revised to reflect this change.

---

# FINDINGS AND RECOMMENDATIONS

---

## **DIGA and DLHIGA**

### ***Finding 05-04:***

The Controller of the DIGA and DLHIGA prepares monthly bank reconciliations. However, once completed, the Controller does not sign and date the reconciliations to denote timely preparation and review.

Reconciliations provide validation that recorded transactions represent real transactions. Per OMB Circular A-123, controls should “allow management and employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.”

The lack of signatures and dates results in a failure to provide evidence of timely completion and management review. AOA was unable to determine if reconciliations were performed timely.

***Type:*** Control Weakness – Validation and Timeliness

### ***Recommendation:***

The Controller sign and date bank reconciliations to signify timely completion.

### ***Auditee Response:***

DIGA and DLHIGA regularly complete bank reconciliations in a timely manner following receipt of the monthly account statements from their bank. Both DIGA and DLHIGA will incorporate into their procedures that the Controller, upon completion of the reconciliations, will sign and date the bank reconciliations indicating the date of completion.

---

# DISTRIBUTION OF REPORT

---

Copies of this report have been distributed to the following public officials:

Executive

The Honorable Ruth Ann Minner, Governor, State of Delaware  
The Honorable Richard S. Cordrey, Secretary, Department of Finance  
Ms. Trisha Neely, Director, Division of Accounting  
The Honorable Jennifer W. Davis, Director, Office of Management and Budget

Legislative

The Honorable Russell T. Larson, Controller General, Office of the Controller General

Other Elective Offices

The Honorable Carl C. Danberg, Attorney General, Office of the Attorney General  
The Honorable Jack Markell, Treasurer, State Treasurer's Office

Insurance Department and Guaranty Associations

The Honorable Matt Denn, Insurance Commissioner, Department of Insurance  
Mr. Julian Woodall, Controller, Department of Insurance  
Mr. Jack Falkenbach, Executive Director, Delaware Insurance Guaranty Association and  
Delaware Life and Health Guaranty Association  
Board of Directors, Delaware Insurance Guaranty Association  
Board of Directors, Delaware Life and Health Guaranty Association